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NSC REVIEW
COMPLETED,
10/31/03

OPERATIONS COORDINATING BOARD

Washington, D.C.

PROGRESS REPORT ON NSC 5402
(IRAN)

REFERENCE: Memo from Executive Secretary, NSC, 1/2/54

OCB FILE NO. 36

WARNING

This document contains information affecting the national defense of the United States, within the meaning of the espionage laws, Title 18, Sections 793 and 794, U.S.C., the transmission or revelations of which in any manner to an unauthorized person is prohibited by law.

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OPERATIONS COORDINATING BOARD
Washington 25, D. C.

November 17, 1954

MEMORANDUM FOR THE OPERATIONS COORDINATING BOARD

SUBJECT: Progress Report on NSC 5402 (Iran)

The attached Operations Coordinating Board Progress Report on NSC 5402 "United States Policy Toward Iran," dated October 13, 1954, was noted by the National Security Council on November 9, 1954, Action No. 1266a.

The NSC further noted (Action No. 1266b) that the NSC Planning Board is reviewing NSC 5402 in the light of the OCB Progress Report.

The previous draft of this report dated October 8, 1954 is obsolete and may be destroyed in accordance with the security regulations of your agency.


Elmer B. Staats
Executive Officer

Attachment:

OCB Executive Officer memo to NSC,
subject as above, dated 10/15/54,
with attachment as listed.

OCB File No. 36

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OPERATIONS COORDINATING BOARD
Washington 25, D. C.

October 15, 1954

MEMORANDUM FOR: Mr. James S. Lay, Jr.
Executive Secretary
National Security Council

SUBJECT: Progress Report on NSC 5402 (Iran)
(Policy approved by the President, January 2, 1954)

There is attached the second Progress Report on NSC 5402 "United States Policy Toward Iran" covering the period from March 30, 1954 through September 30, 1954. This report was approved by the Operations Coordinating Board on October 13, 1954.

Since the end of the period covered by this report, it was agreed among the Department of State, the Treasury and the Foreign Operations Administration that upon receipt of assurances from the Iranian Government that it will take effective action for better control and direction of use of its revenues, the level of aid for Iran for fiscal year 1955 will be established at \$8.5 million technical cooperation funds, \$13 million development assistance in support of technical cooperation activities (\$2 million of this amount will be on a loan basis), \$22.8 million development assistance for budgetary support and \$83 million in loans (\$30 million of this amount will be for budgetary support, \$18 million for the Karaj Dam Project and \$35 million for other development projects).

Elmer B. Staats
Elmer B. Staats
Executive Officer

Attachment:

Progress Report on NSC 5402 (Iran),
dated October 13, 1954.

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October 13, 1954

PROGRESS REPORT ON NSC 5402
"UNITED STATES POLICY TOWARD IRAN"

(Policy approved by the President, January 2, 1954)

A. SUMMARY OF MAJOR ACTIONS

1. The outstanding accomplishment has been the development and submission to the Iranian parliament of an oil agreement which meets the objectives set forth in NSC 5402.
2. In recent months the Zahedi Government has taken significant steps away from the traditional Iranian foreign policy of "neutralism." It rejected firmly a Soviet note which had accused Iran of hostility to the USSR. It has refused to make political concessions in current frontier and war debt negotiations with the USSR. It has uncovered and is in the process of liquidating a communist network in the armed forces. It has instructed its UN delegation to follow U.S. guidance. Most significant, the question of joining in regional defense arrangements is now receiving considerable favorable treatment in the press; while the Shah and Government leaders have given private assurances to U.S. officials of their willingness eventually to make open commitments of a nature which would clearly place Iran among anti-communist forces.
3. Since the Zahedi Government came to power, the United States Government has provided \$70 million of emergency economic aid and approximately \$23 million of technical cooperation funds. Iran's FY 1955 needs for emergency aid in addition to that already provided are presently under discussion; the technical cooperation program is expected to be about \$21.5 million in FY 1955. Without this aid the Shah and the Zahedi Government would not have been able to maintain internal stability or proceed with the oil negotiations.
4. U.S. military aid programs for Iran have been developed with the objective of enabling the Iranian armed forces to maintain internal security and provide some resistance to external aggression. There have been continuing indications of improvement in the ability of the Iranian armed forces to maintain internal security; however, these forces are not yet capable of providing effective resistance to external aggression. As a means of accelerating training in defensive warfare, MDA funds have been provided to permit "on-sites" training of the Iranian Army in the strategic mountain passes. An Iranian request for the provision of five U.S. training teams, intended to function at brigade and division level, has been approved.

and will provide a total of 65 officers and 125 enlisted men to augment the present U.S. training missions in Iran. The full benefit from these teams will not become apparent for approximately one year after their arrival in Iran (January 1955).

5. A currency reform bill was approved by Iranian Majlis in July, freeing \$7 million in foreign exchange for the purchase of imports and permitting an increase in the note issue.

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B. OPERATIONAL CONSIDERATIONS BEARING ON POLICY

8. The policy enunciated in NSC 5402 is somewhat outdated by events; and, when an oil agreement goes into effect, whole sections will no longer be pertinent, while considerable revision of other sections will be required. As reported in Paragraph 20, action is being taken under existing policy regarding expanded military and economic aid programs. However, as explained elsewhere in this report, it is desirable for the NSC to complete an early review of NSC 5402.

9. With reference to Paragraph 23 of NSC 5402 it is believed that more problems would be created than resolved by securing at this time designation of a successor to the throne. In fact there would be a serious risk that this might serve to increase the possibility that the Shah would be replaced during his own lifetime. There are people in Iran, including several of the Shah's brothers, who would like a change; but, whereas they cannot now easily mobilize their forces for this purpose, naming a successor could very well serve to assist that process. The weakening of the Shah's hold on the throne which might result would not be consistent with Paragraph 19 of NSC 5402 which, among other things, calls for enhancing the prestige of the monarchy. In addition the Shah is still a young man and, the situation in Iran being susceptible to sudden and extreme changes, whoever might be deemed the most suitable successor at this time might not be the most suitable man to take over at the time of the Shah's death. However, it is important to have plans within the U.S. Government for meeting the contingency which would arise in case the present Shah dies or is otherwise rendered incapable of further reign. The United States should be prepared to support either a successor to the throne perhaps with a Regency Council, or individuals or arrangements which would establish a government friendly to the United States. The possibility of discussing certain of the U.S. contingency plans with the Shah should not be eliminated.

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C. EMERGING PROBLEMS AND FUTURE ACTIONS

10. With the anticipated resumption of oil operations major problems with which the U.S. must be concerned are emerging:

(a) Petroleum revenues in the first year or two of operations will not be adequate to cover politically necessary increases in budgetary expenditures and projected development programs.

(b) Lack of coordination within Iran and commercial rivalries among Western nations are likely to keep Iran financially over-extended and waste a large proportion of the oil revenues, particularly if U.S. influence over Iran's economic and financial policies is allowed to diminish.

(c) The combat capabilities of the Iranian armed forces must be improved, involving U.S. military and economic aid as well as certain reforms within the Iranian military establishment, if Iran is to join and contribute to regional defense arrangements.

(d) Iran cannot achieve political stability for more than brief periods unless badly needed financial, administrative, judicial, and other reforms are enacted.

(e) The success of U.S. actions in Iran during the next two years is heavily dependent upon the ability of the Iranian Government to sustain public support for the oil settlement and for its new orientation in international affairs. Accordingly, the U.S. will have to assist Iran in developing and extending its public information efforts.

Should the projected visit of the Shah to the U.S. materialize, these problems will be highlighted immediately.

11. Although the policy provides for the continuation of emergency economic assistance until Iranian receipts from oil operations reach "substantial" proportions, there has been a tendency in some quarters to feel that with the solution of the oil problem there need be little further concern with the Iranian situation. However, on-the-scene observers agree that the Iranian people must see early tangible benefits from the oil settlement in terms of economic and social progress if the oil settlement is to be firmly established and the present prestige and authority of the Shah is to be maintained. Yet income from oil operations probably will not commence before February 1955 and in any event is not likely to exceed \$60 million in the first year. Income of this magnitude is not sufficiently substantial to permit the Iranian Government to offer these tangible benefits which the people of the nation expect.

12. Traditional Iranian foreign policy has been to take advantage of the rivalry of major foreign powers, without taking sides. Iranians have long known that the primary objective of U.S. policy toward Iran is to support that country's independence. This policy was clearly demonstrated in 1946 at the time of the Azerbaijan crisis.

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and was apparent even during Mosedeq's premiership in the repeated, though fruitless, endeavors to meet his terms in the oil dispute. When the Zahedi Government came to power in August 1953, emergency U.S. support was immediately granted and was continued during the entire course of the oil negotiations. Ambassador Henderson and Mr. Herbert Hoover, Jr., have emphasized that by that action this government undertook a "moral commitment" to establish firmly the Iranian leaders who turned away from Mosedeq's policies and have recently taken a number of decisive anti-communist actions which were controversial in Iran and, in some instances, provocative toward the USSR. In encouraging future independent action by Iran in asserting its rights as a member of the community of free nations, care must be taken to avoid indications of a lack of U.S. appreciation of the position in which Iranian leaders have placed themselves partially at our urging.

13. For these reasons the U.S. Government is planning to continue emergency aid to Iran at least through the U.S. Fiscal Year 1955. Present estimates show a need for about \$42 million additional budgetary assistance most of which may be in the form of loans. Studies are being made of possible sources of these funds.

14. In addition to continuing emergency economic aid, FOA plans to continue technical and economic aid to Iran for FY 1955. A \$21.5 million technical cooperation program (\$8.5 million of technical assistance and \$13 million of development assistance) has been approved to continue programs of public health, education, agricultural improvement and similar activities. All competent observers agree that if the U.S. technical cooperation program were to be discontinued, the Iranian Government would, in all probability, not be able to lay stress on the programs which the U.S. considers to be most important. Consequently, the progress of the past few years and a clearly perceptible momentum to further progress would be seriously jeopardized, if not lost.

15. Beyond the requirements for emergency aid, which are primarily designed to meet the Iranian Government budgetary deficits, and the technical cooperation program is a need to initiate an economic development program. While a portion of the anticipated oil revenues can be devoted to this purpose, available funds in the first months of petroleum operation will be insufficient to enable the government to undertake a development plan of the magnitude which the people expect. Consequently, the Iranian Government has approached the Eximbank for assistance. One specific project, the Karaj Dam near Tehran, has been submitted to the Bank and the possibility of a "line of credit" by the Bank has been discussed within U.S. Government circles.

16. The mere prospect that oil income would be resumed in the near future has created serious problems with respect to procurement and various development schemes. Lack of planning and a failure to coordinate programs, combined with the pressures of special interest groups, both Iranian and foreign, have already caused a serious over-commitment of anticipated revenues. The danger is that these pressures will continue and that the Iranian Government will find itself constantly over-committed with respect to uncoordinated and conflicting plans and consequently unable to carry out the kind of development program which would bring economic and social benefits to the people. A major problem, therefore, is to assist competent Iranian officials in bringing this situation under control and to provide for an orderly development program. Ebtehaj, a strong-willed and competent man who clearly understands the need for a coordinated development plan, has been installed as Director of the Plan Organization; he could help to improve this situation, particularly if he is delegated sufficient power over development funds. However, in offering further aid to the Iranian Government it will be important that the U.S., as a condition of extending assistance, secure commitments guaranteeing reasonably effective coordination of development schemes -- yet avoiding the appearance of U. S. domination or control over the use of Iranian resources or discriminating against other nationalities. It has been suggested that in return for such a commitment the U.S. make a package offer to Iran including \$42 million for budgetary assistance, most of which may be on a loan basis, \$21.5 million for a technical cooperation program, and approximately \$55 million in development loans. No decision on this proposal had been reached as of September 30.

17. Anti-settlement and anti-Western propaganda by Tudeh and other dissident forces will probably be stepped up after the settlement. The Soviet Radio can be expected to step up its propaganda pressure along these lines.

The Iranian Government's ability to handle these attacks will depend in large part upon its substantive programs for bringing the benefits of a settlement to a significant portion of its people. However, it should strengthen its ability to exploit its progress in this through information media. The government has already asked the Embassy for assistance along these lines. Some U. S. Government assistance will, in fact, be necessary if an effective Iranian government domestic information program is to be instituted in time to counteract effectively anti-settlement and anti-Western propaganda in the coming months.

18. There is no doubt that without badly needed reforms the prospects for long-range political stability in Iran are not good; indeed, there are valid reasons to support the thesis "at until Iran has undergone extensive reforms affecting vitally its society and economy, the country will not be able to enjoy political stability for more than brief periods. To a much greater extent than ever before the Iranian public demands demonstrable

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evidence of progress; also the Government itself is aware that such progress in the near future may be essential to the very existence of Iran as a free nation. On the other hand, over-hasty and ill-planned reforms undertaken with a Government apparatus not equipped to put them smoothly into effect could lead to bitter internal dissension, including the strengthening of class and other hatreds, and could seriously undermine the stability of the country eventually resulting in chaos. Since the Army consists of conscripts who reflect public attitudes, its improvement should be accompanied step by step with improvement in the civilian society through economic programs and reforms.

19. Responding to the Shah's desire to visit the U.S., the President has agreed that this visit may take place after November 1. The Shah's visit in 1949 became a liability to the U.S. because of the Shah's exaggerated expectations regarding material benefits and assurances obtainable from the United States. The Shah has said that he would desire while in the U.S. to have frank talks with appropriate U.S. officials relative to problems such as Iranian participation in Middle East regional defense and our plans for improving Iran's defense capability. The Shah will expect that the U.S. officials with whom he talks (a) have concrete constructive proposals to make to him regarding U.S. plans for the organization, training and equipping of Iran's armed forces; (b) talk to him frankly of our hopes of improving Iran's defensive capacity and of the difficulties involved; and (c) have decided at all levels the role Iran should play in Middle East defense arrangements.

20. The Shah has long advocated U.S. support of an Iranian army capable of delaying a Soviet advance across Iran and defending the Zagros Mountains as the keystone of any plan for the defense of the Middle East. He has also given to U.S. officials informal personal assurances that Iran would participate in regional defense arrangements provided the U.S. will assist in developing Iran's military capabilities to the point where it can make a contribution to the defense of the area.

21. The Shah must face certain political problems in (a) participating in area defense arrangements which represent a dramatic departure from Iran's traditional foreign policy, and (b) risking the alarm and opposition which might result from the movement to Zagros defensive positions involving abandonment of major areas of Iran in time of war. Furthermore, the present Iranian armed forces are badly in need of additional training. There is a need for an effectively enforced system of reward and punishment, improved pay, the removal of corrupt, unfit and inefficient officers and noncommissioned officers. These deficiencies, the correction of which is primarily the task of the Iranian authorities, must be eliminated before significant increases in efficiency can be expected. There is also a need for improving the Iranian Gendarmerie and Police in order to relieve the armed forces from their primary mission of internal security. Necessary budgetary support for the Gendarmerie from the

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Iranian Government has been lacking. Improvement of the defensive capabilities of the Iranian armed forces would involve the movement of certain units, munitions, storage facilities and living quarters to less exposed positions in the south and southwest of Iran. This relocation of forces and equipment cannot be undertaken by the Iranian Government alone, and would require substantial U. S. grant defense support and economic aid for a period after the resumption of oil revenues.

22. In implementation of present NSC policies, the OCB on September 29 noted the changed circumstances in Iran arising from the oil settlement, the apparent willingness of the British Government to entertain discussions concerning such action. The Board concluded that as a matter of urgency:

(a) FOA should develop an economic and defense support program for Iran immediately.

(b) The Department of Defense should consider an expanded military program consistent with these circumstances and with Iranian capacity to absorb such a program.

23. Before informing the Shah of U.S. plans for future aid to the Iranian armed forces, the U.K. Government should be informed and its support sought. Lack of agreement between the U.S. and U.K. could jeopardize the success of this program.

24. When the U.S. Government's position on an expanded military aid program for Iran is clear, and the British have been informed, the Shah should be advised of the nature of our program to improve the capability of the Iranian armed forces. Should he accept these proposals and give assurances of the readiness of the Iranian Government to implement the necessary military reforms and relocation of units, we must be prepared to take advantage of Iranian willingness to assist in the collective defense of the Middle East.

D. EXTENT OF AGENCY INTERESTS

25. The Department of Justice has played a major role in achieving an oil settlement. The Attorney General's action in January and in September 1954 to render opinions upon the participation of American oil companies in the agreements to return Iranian oil to world markets was essential to the success of the program. The Attorney General and his staff in the Anti-Trust Division acted with commendable speed and with full comprehension of the national interest involved in an early and equitable settlement of the Iranian oil dispute.

26. The Treasury Department has also assisted in achieving an oil settlement in seeking to minimize the Iranian over-commitment of resources, in encouraging economic and financial reforms in Iran, and in exploring how, and in what amounts, to extend further assistance to the Iranian Government. The Secretary of the Treasury consulted with representatives of American firms participating in the consortium on numerous aspects of the oil negotiations, including the question of U.S. tax credits for taxes paid to the Iranian Government and the relationship between royalties and tax payments to Iran. Tax rulings were issued to the American oil companies involved, permitting income tax payments to the Iranian Government to be credited against the tax liability to the United States. Treasury officials also discussed with representatives of the British Government both the terms of currency agreement between the United Kingdom and Iran designed to accompany an oil settlement and the over-commitment of Iranian resources under British and Western European sales pressure. The Treasury made available the services of its Middle East Representatives to assist the Embassy in Tehran on economic and financial problems during a substantial part of the period covered by this report.

~~TOP SECRET~~ANNEX "A"DETAILED DEVELOPMENT OF MAJOR ACTIONSPara. 15. Facilitate Iranian Oil Settlement

a. "Assist Iran again to obtain substantial revenues from its oil resources."

b. "Assist in every practicable way to effect an early and equitable settlement of the oil controversy between the United Kingdom and Iran."

c. "If on June 1, 1954 such a settlement is still unachieved, and it appears likely that the negotiations will fail, review U.S. policy toward the problem in the light of circumstances then existing, including giving consideration to taking independent action with Iran, in order to bring about a resumption of revenues from its oil resources as a stabilizing influence in the Government of Iran to obviate the need for U.S. emergency economic assistance."

d. "In implementing actions under b and c above, seek to avoid establishing any precedent which would adversely affect U.S. interests in Middle East resources."

By June 1, 1954, it was clear that such progress had been made in the direction of a settlement of the Anglo-Iranian oil dispute that it would not be necessary to consider "taking independent action with Iran." On August 5, an agreement on major substantive points was reached between eight major oil companies and the Iranian Government. Following study by lawyers on both sides and further negotiations on various points, an agreement was signed by all the companies and the Iranian Government by September 20 and was immediately submitted to the Iranian Majlis for ratification. Parliamentary debate was still continuing on September 30. If parliamentary ratification is obtained and the agreement is promulgated by the Shah, paragraph 15 will no longer be pertinent to the Iranian situation.

Para. 16. Continue emergency economic aid pending reestablishment of substantial revenues.

There is little doubt that the provision of United States funds for budgetary support of the Zahedi Government helped maintain more stable economic conditions in the country which were so essential to creation of a favorable atmosphere for the continuation and conclusion of the successful negotiations toward an oil settlement.

During the six months ending September 30, 1954, an additional \$25 million in economic aid was granted to help meet Iran's budget deficit through this period which brought the total that the United States has granted for this purpose since Zahedi assumed control to

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the government to \$70 million.

These dollars were, in effect, sold to Iranian importers for local currency which was turned over to the Iranian Government and applied to meet the government's expenditures, including payrolls of civil servants and the military. On March 21, which marks the Iranian New Year, for the first time in many months the government was able to meet its payrolls on time.

The availability of sufficient local currency also permitted the government to meet minor wage increases due the under paid armed forces, and to continue work on some public works type projects, including road building and housing construction that have given work to numbers of unemployed.

In raising the local currency quite naturally the flow of essential imports into the country, including sugar and other vital goods, has been considerably increased, helping to hold down the rate of increase in the cost of living. However, the availability of United States aid made it possible for the Iranian fiscal authorities recently to appreciate the rate of exchange against the recommendations of the International Monetary Fund and the United States advisers on the scene. This action has had the effect of stimulating import demand; still further and of increasing the number of dollars of United States assistance required to meet the Iranian budgetary deficit.

During this period the budget deficit, financed by United States aid, had averaged approximately \$5 million a month. The conclusion of an oil settlement is expected to create irresistible pressures for increased expenditures, including long-delayed salary increases for the military forces and for civil servants, as well as payment of many long overdue obligations. It is anticipated that Iranian Government expenditures will have to be increased almost immediately after the conclusion of an oil settlement by approximately 35 percent or roughly the equivalent of \$5 million a month. Unless this is done, communists and irresponsible Iranian demagoguery will surely take advantage of explosive public frustrations. Consequently, even though oil income during calendar year 1955 is expected to average \$5 million a month it may well be necessary for the United States to continue to provide budgetary support for another year at substantially the rate required in the past six months.

Para. 17. Continue Limited Technical and Economic Aid

During this period, the Technical Cooperation Program was further integrated with Iranian Government operations through the creation of a Master Joint Fund, which for the first time involves the Iranian Government in the administration of the program although government ministries have, of course, heretofore been participating in the technical aspects of the program. The USOM Director and the Minister of National Economy are co-directors of the Joint Fund and administer

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the program authorized by the existing Iranian-United States Joint Commission. The new Iranian budget makes provision for an allotment of more than a \$1 million in local currency for the Master Joint Fund.

Three-year contracts for carrying on agricultural projects and activities in public administration were entered into with two American universities. The Public Statistics and Public Health Cooperatives, both Iranian-United States joint organizations continued carrying on their operations successfully. The Public Statistics Cooperative laid further plans for the first census to be conducted in Iran. Through a project of the Public Health Cooperative, over 8,000 villages were protected from malaria. In many areas the disease has already been almost completely eradicated.

An income tax study completed by an American expert contained recommendations for certain administrative changes that the Ministry of Finance adopted. If successfully carried out, these changes hold promise for much larger government revenue.

An engineering and evaluation report for the construction of a multi-purpose dam at Karaj near Tehran was completed by the Bureau of Reclamation for FOA. Preliminary construction work has already been started. The Iranian Government is now seeking a loan from the Export-Import Bank to finance the construction of the dam.

Para. 18. In implementing above courses of action: Consult with UK without impairing US-UK Relations, without permitting UK veto of US actions and seeking UK agreement to solution oil problems while supporting Zahedi Government.

This directive has been complied with during oil negotiations and in consideration of Iran's economic problems. When an oil agreement becomes effective, the need for this paragraph becomes much less significant.

Para. 19. a) Provide grant military aid to Iran to maintain internal security and provide some resistance to external aggression; and b) to enhance the prestige of the monarchy and the morale of the Iranian Government and military services.

As of 31 July 1954, the cumulative value of military aid shipments to Iran was \$76.3 million. Reports of deliveries between 31 July and 30 September 1954, are not yet available. The Navy and Air Force portions of the supplemental FY 1950-54 \$14 million program have been approved. The air portion of this program provides for the introduction of jet aircraft into the Iranian Air Force. During September 1954 the Chief MAAG-Iran submitted a supplemental FY 1950-54 program for military equipment for the Iranian Army in the amount of \$9.9 million. This request is now being processed.

As a means of assisting the Iranian armed forces in developing a capacity to resist external aggression, \$100,000 of Army MDA funds

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were provided to assist the Iranian Army in conducting "on-site" training in delaying defensive warfare in the strategic mountain passes. An Iranian request for the provision of five U.S. military training teams, intended to function at brigade and division level, has been approved. These training teams will provide a total of 65 officers and 125 enlisted men to augment the present U.S. training mission in Iran.

A plan for reorganizing and enlarging the Iranian armed forces was reviewed by the Joint Chiefs of Staff on 24 September 1954. After careful consideration of this proposal the JCS concluded that:

a. Approval of any major increase in a military assistance program for Iran or any other Middle Eastern country should be withheld until the military requirements for the Middle East have been reviewed, either as a result of combined US-UK-Turkey military planning studies or the development of a regional defense organization;

b. The value of materiel to be programmed for Iran should not be increased over that already planned until the Iranian Army has demonstrated the capability to utilize additional material effectively; and

c. Appropriate defense support and economic aid are desirable in conjunction with the present MDA Program for Iran.

The cost of the plan, as reviewed by the JCS, was estimated at \$360 million over a three-year period. This cost can be divided into \$122 million required from the Foreign Operations Administration for defense support and economic aid and \$238 million required from the Department of Defense for military assistance. Coordination integrating U.S. military and economic assistance programs for Iran is essential.

Para. 20. The amount and rate of military aid to Iran should take into account Iran's attitude toward the aid and cooperation with the free world and Iran's ability to absorb the aid and its willingness to formalize contracts for military aid and training.

Iranian leaders presently seem more favorably disposed toward military cooperation with neighboring countries than they have been in the past. Some improvement in Iran's ability satisfactorily to absorb military equipment and training has been noted. Any increase in the value of materiel to be programmed for Iran should be related to a demonstrated capability to utilize additional materiel effectively. Iran has now formalized the necessary contracts for military aid and training by means of an exchange of notes with the United States.

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Para. 21. Encourage Iran to cooperate militarily with its neighbors.

The Shah has assured American representatives in Iran that he wishes to align Iran with the West but wishes the Iranian armed forces first to achieve certain defensive capabilities. Although it would be counter-productive to demand open commitments at this time from the Iranian Government in regard to joining in regional defense arrangements with its neighbors, the Shah has stated firmly that as soon as he saw the prospects of Iran being able to contribute to the defense of the area, Iran would open military discussions with Turkey, Pakistan and Iraq. Also, it is likely that as those three countries move forward toward increased military capabilities and cooperation, there will be stronger incentive for Iranian participation in joint defensive planning.

Para. 22. Attempt to direct Iranian Nationalist feeling to constructive channels and bear in mind desirability of strengthening the Iranians to resist communist pressure.

The Zahedi Government, which came to power in an atmosphere of public anxiety over the growing influence of the communists, has been actively suppressing communist activities. The communist organization has been disrupted and its operations have been almost totally obstructed. During the past month a communist network in the Iranian armed forces has been uncovered and is in process of liquidation. Some 500 officers and men were involved, many of them communist agents of long standing. Government leaders and the Iranian public were shocked at this revelation of the extent of communist penetration of the security forces, and now have a greater realization of the communist threat.

The Zahedi Government has demonstrated its anti-communist attitudes in other ways. On July 8, 1954, the government firmly rejected the accusations of a threatening Soviet note regarding Iran's current policies. The Iranian press applauded the vigor of the government's reply, particularly noting the statement that "Iran can, for the protection of its independence and its internal security, join any local alliance that we consider necessary."

The government has taken more than suppressive actions towards communist activities. Iranian teachers and officials of the Ministry of Education have long been susceptible to communist propaganda because of their low wages. With parliamentary approval the Zahedi Government raised the pay of teachers, and it is reported that the passage of this bill immediately resulted in a decrease in attendance at communist cell meetings. Another major step along this line of combatting communism without police suppression was the successful visit of the Shah to Azerbaijan which evoked enthusiastic pro-monarchy emotions and demonstrations.

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The draft plan is currently being reviewed by the Embassy at Tehran.

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USIA and other Embassy elements are also taking steps to impress upon the American oil companies who are members of the consortium the importance of a firm, constructive consortium public relations policy. The aim of such a policy should be to demonstrate to the Iranian people that the consortium intends to operate in the best interests of Iran.

Para. 23. Encourage Iran to adopt necessary financial, judicial, administrative and other reforms and to provide orderly succession to the crown.

The Iranian Government and Parliament have been primarily occupied with the business of obtaining a settlement of the oil dispute and reestablishing oil operations, while suppressing communist and extremist activities in Iran. A program of expulsion of communists from the government bureaucracy has met with considerable success, and there was recently discovered and destroyed a deep-laid communist network in the armed forces.

The need for basic administrative reforms in Iran has long been apparent to foreign observers. Until recently however, such foreign advice as was given Iran (largely in the form of formal reports) went mostly unheeded. More recently FOA technicians have been able to demonstrate in certain branches of government the positive worth of administrative reforms. Technical advice in this field is planned to be continued as an integral part of the FOA program in Iran.

In July, the Iranian Government obtained passage from the Majlis of a currency reform bill containing many of the recommendations which

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had been suggested by the U.S. and by an IMF mission. The new measure provided greatly increased flexibility in monetary matters by: a) eliminating the absolute ceiling on the currency issue, and b) requiring that only 40 percent of the currency backing need be in gold or dollars. The new law enabled the Bank Melli to release for use in purchasing imports \$7 million which had been held as a part of the note cover and to increase the note issue somewhat.

In order to secure approval of the currency reforms from the Majlis, however, the government had to commit itself to an appreciation of the exchange rate, contrary to IMF and U.S. recommendations. Thus, while the immediate U.S. objectives with respect to currency reforms have been substantially achieved, further reforms in the exchange rate structure are desirable. The United States Government is continuing to encourage the revision of the exchange rate system as politically appropriate.

With the prospect that oil income would be resumed in the near future, a chaotic situation has developed with respect to the timing, extent and coordination of the procurement of capital goods and the competing priorities of various development projects. Lack of planning and a failure to coordinate programs, together with the pressure of special interest groups have led to a serious over-commitment of anticipated revenues. The Embassy has been instructed to urge the Iranians to bring this situation under control. In addition, the Secretary of the Treasury requested the cooperation of the British Government in avoiding exploitation of Iran by British interests. While the Chancellor of the Exchequer pledged his wholehearted cooperation, there are still evidences of irresponsible commercial opportunism on the part of British Government Representatives in Tehran and British commercial interests. A favorable development which may lead to some reforms is the recent appointment of Ebtehaj as Director of the Plan Organization. Ebtehaj has long been keenly aware of the need for coordinating economic development schemes. He has suggested the recruitment of a number of foreign technicians and specialists in economics and engineering to aid in this effort. The United States stands ready to cooperate with Ebtehaj in obtaining the necessary persons.

An American tax specialist has completed a survey of the Iranian tax system and the Government of Iran appears receptive to early adoption of the major recommendations of the survey.

In the field of education, significant steps have been taken toward improvement of Iran's educational system along American lines, including the revision of the entire Iranian school curriculum, including expansion of the school system to tribal and other areas where schools have been either totally lacking or of very low standards.

The question of providing orderly succession to the crown has been dealt with in Section B.

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Para. 25. United States should prepare plans to meet the contingency of an attempted or actual communist seizure of power in one or more of the provinces in Tehran.

The Joint Chiefs of Staff have approved a plan which was prepared to meet this contingency. A recently approved annex to this plan includes the provision of ammunition and medical supplies to an Iranian Army of 150,000 in support of the basic operational plan. The status of plans for covert operations will be reported on separately. Reference is made to the Progress Report on NSC 5402 dated March 29, 1954, concerning plans for UN action.

Para. 26. As part of contingency planning carry on politico-military-economic discussions with the UK for plans to meet contingency of communist seizure of complete control of Iran so rapidly that no government is available to request assistance from free world.

Contingency planning for these eventualities is being carried on by the interested departments and agencies.

Para. 27. Contingency plans and policies in the event of an attack by USSR military forces against Iran.

Contingency planning for these eventualities is being carried on by the interested departments and agencies.

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